

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Price Cap Performance Review for Local)	CC Docket No. 94-1
Exchange Carriers)	
)	
Access Charge Reform)	CC Docket No. 96-262

COMMENTS OF CINCINNATI BELL TELEPHONE COMPANY

Cincinnati Bell Telephone Company (“CBT”), an independent, mid-size local exchange carrier submits these comments in response to the Commission’s November 15, 1999 Further Notice of Proposed Rulemaking in the above captioned proceeding.¹ In this proceeding the Commission seeks comments on how it should represcribe an X-factor in light of the reversal and remand of the current X-factor by United States Court of Appeals for District of Columbia Circuit.² In addition, the Commission seeks comment on resetting price cap LEC prices on a forward-looking basis, to rebalance the sharing of benefits between LECs and their customers.

I. INTRODUCTION

The Court in its decision determined that the Commission did not rationally explain its choice of a 6.5% X-factor. The Court found the Commission’s explanation lacking on two fronts. First, the Commission “failed to state a coherent theory supporting its choice of 6.0%” for the historic productivity component of the X-factor. Second, the Commission did not explain why the Consumer Productivity Dividend (“CPD”) remained the same even though the reason for including a CPD is supposedly different than under the original X-factor.

¹ *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1 and *Access Charge Reform*, CC Docket No. 96-262, *Further Notice of Proposed Rulemaking*, released November 15, 1999.

² *USTA v. FCC*, 188 F.3d 521 (D.C. Cir. 1999).

As it relates to the choice of 6.0%, the Court found the Commission's decision to discount the effect of the lowest averages when choosing a point within the range of reasonableness of historical productivity growth to be "mystifying." It also questioned the Commission's finding of an upward trend in the X-factor. Finally, the Court found the Commission's decision to give independent weight to AT&T's methodology to be irrational. For all of these reasons, the Court remanded this choice of a 6.0% historic productivity component to the Commission for further explanation.

The Commission argued that the CPD was retained to reflect the expected productivity gains LECs will realize due to the elimination of sharing. While not specifically addressing the Commission's argument, the Court found that if this was the basis for retaining a CPD, the Commission did not justify why 0.5% is the appropriate amount for such an adjustment. If a CPD is to be included to account for any productivity gains due to the elimination of sharing the Commission must conduct some analysis of the impact this will have compared to the impact on productivity included in the original X-factor, which the Commission said was designed to address productivity improvements relative to rate-of-return regulation.

The FNPRM examines three approaches to represeting the X-factor. Option 1 simply addresses the problems identified by the Court. Option 2 attempts to make several "corrections" to the 1997 model, while Option 3 presents an alternative method of calculating the X-factor in order to yield "the aggregate revenues that would have been generated in a competitive market." (FNPRM at ¶35) CBT urges the Commission to use Option 1, which addresses the Court's concerns and does not raise any new problems that would undoubtedly be subject to further appeals.

The FNPRM also seeks comment on how to apply the X-factor on a going-forward basis and if a CPD should be included prospectively. The FNPRM suggests using the 1999 Staff TFP study (Option 2) or the Staff Imputed X study (Option 3) prospectively. Rather than either of these options, CBT supports the use of a corrected TFP model (Option 1) updated with the most recent data. CBT submits that the CPD should be eliminated.

The FNPRM also seeks comment on how the prescription of the X-factor would affect smaller price cap LECs differently from other price cap LECs, and whether there should be a separate X-factor calculated for smaller price cap LECs. (FNPRM at ¶48) CBT has advocated for a separate X-factor for smaller price cap LECs since 1989 and urges the Commission to definitively address the evidence on the record by prescribing a separate lower X-factor for the smaller price cap LECs.

II. THE COMMISSION'S NEW MODELS ARE FLAWED AND SHOULD BE REJECTED

Of the three options the Commission presents for represcribing the X-factor for the period addressed by the Court and for prescribing the X-factor going forward, only Option 1, correcting the errors and updating the 1997 TFP Study, is economically sound. Option 2, the 1999 Staff TFP Study, and Option 3, the Staff Imputed X Study, have serious deficiencies. These deficiencies are thoroughly discussed in the USTA Comments and accompanying attachments being filed in this proceeding.³ CBT fully concurs with the USTA analysis, and therefore, will not discuss the deficiencies of options 2 and 3 herein.

CBT can conceive of no rational reason why the Commission has put so much effort into developing the 1999 Staff TFP Study and the Imputed X Study when the Court found no fault

³ See Comments of the United States Telecom Association on the Further Notice of Proposed Rulemaking in *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1 and *Access Charge Reform*, CC Docket No. 96-262, filed January 7, 2000.

with the basic TFP approach used in the 1997 Study. All that is required of the Commission in response to the Court's remand is to correct the areas that the Court found lacking. Specifically, the Commission should no longer discount the lowest averages (i.e., give equal weight to each average), reject its previous unsupported assumption that an upward trend exists, and not include an adjustment for AT&T's higher estimates. The Commission should also eliminate the CPD. These corrections could have been made based on the existing record with no need for a FNPRM. Instead, it appears as if the Commission has decided in advance the result it wants and has designed options 2 and 3 to produce this desired result. Not only is such an approach economically unsupportable, its derivation is even more arbitrary and capricious than the Commission's 1997 X-factor that the Court rejected for lack of a rational explanation.

Particularly troublesome to CBT is the uncertainty that the continual modification of the X-factor creates. Changes in the X-factor can result in very significant financial impacts for individual carriers. The uncertainty confounds economic efficiency and thwarts the investment incentives of the carriers.

The Commission now has the opportunity to eliminate this uncertainty. The basic 1997 TFP methodology has already been scrutinized by the Court and, except for the few adjustments made by the Commission, has been found to be an appropriate measure of ILEC productivity growth. This methodology, with the corrections indicated above, should be adopted for the July 1, 1997 to June 30, 2000 period. It should also be used prospectively after updating with data from the more recent years.

Under no circumstances should the Staff Imputed X Study be used to set the X-factor. This X-factor methodology is nothing more than a convoluted means of reinstituting rate of return regulation. Furthermore, it attempts to develop an interstate only X-factor that the Commission

and the Court have both previously rejected.⁴ The Imputed X Study cannot be corrected in any way that could justify its use for prescribing the X-factor.

The errors in the 1999 Staff TFP Study can be corrected, as demonstrated in the USTA comments.⁵ However, since the corrected study results are very similar to the 1997 TFP results,⁶ CBT sees no reason to adopt a new study when the 1997 TFP study has already been shown to be sound.

III. THE EVIDENCE SUPPORTS A SEPARATE, LOWER X-FACTOR FOR MID-SIZE PRICE CAP LECs

Since the Commission first began considering price cap regulation for incumbent LECs, there has been significant evidence that there should be a separate, lower X-factor for smaller LECs relative to the large carriers. Ten years and numerous studies later, the evidence remains the same—a differential of 1.0% - 1.5% exists between the productivity growth rate of large carriers versus smaller carriers. The fact that there are fewer small price cap LECs than a few years ago does not make the case for a separate X-factor less compelling; the impact of an incorrect X-factor on individual companies can be significant. After ten years of contemplating the issue of how to address the smaller price cap carriers, it is time for the Commission to take decisive action and prescribe a separate, lower X-factor for the mid-size price cap ILECs.

A. The Record Contains Ample Evidence Supporting a Separate, Lower X-factor for Mid-Size LECs

Studies documenting an independent LEC differential were presented as early as 1984 when Christensen compared the TFP of the Bell System with that of the independent companies and

⁴ FCC, Brief for Respondents at 41 and *USTA v FCC*, 188 F.3d 521 (D. C. Cir.).

⁵ See USTA Comments filed January 7, 2000 at page 14.

⁶ *Id.*

found an average of 1.3% lower productivity between the independents and the Bell System.⁷

Many other studies have been conducted since that time, all showing at least a 1.0% differential between the smaller/mid-size LECs, and the large companies. CBT alone has submitted at least five studies since 1989. Below is a brief overview of the findings of CBT's studies and several others:

- In 1989 CBT performed four separate studies employing various methodologies which showed a differential of 1.0% - 3.0%.
- 1989 studies by SNET showed a differential of 1.0% - 4.4%.
- 1989 study by Rochester showed a differential of 1.78%.
- 1989 study prepared by NERA for USTA showed a differential of 1.65% - 2.77%.
- 1991 study prepared by NERA for Centel showed a differential of 1.5%.
- 1997 study by Strategic Policy Research for CBT showed a differential of 1.5 % - 3.1% per year.
- 1998 study submitted by the Independent Telephone and Telecommunications Alliance showed a differential of 1.0% - 2.0%.

B. Smaller ILEC Differences Recognized by the Commission

The FNPRM asks for comment on whether there should be a separate X-factor calculated for smaller price cap companies. (FNPRM at ¶48) This is not the first time this question has been raised. The Commission first questioned the appropriateness of a single X-factor for all companies in 1989 and the issue has been raised in virtually every X-factor proceeding since that time. Specifically, the issue has been raised in the following proceedings:

- Second Further Notice of Proposed Rulemaking, CC Docket No. 87-313, released April 17, 1989 at ¶698. "We recognize, however, that the possibility continues to exist that the 2.5 percent productivity factor may prove unduly burdensome for

⁷ *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, *Second Report and Order*, released October 4, 1990 at ¶107.

small telephone companies. This Commission has acknowledged in the past that such companies may have fewer opportunities than larger companies to achieve cost savings and efficiencies, and we have made policy decisions in accordance with this principle.”

- Supplemental Notice of Proposed Rulemaking, CC Docket No. 87-313, released March 12, 1990 at ¶101. “Independent LECs, who are for the most part smaller in size than the BOCs, argue that they have fewer opportunities than larger companies to achieve cost savings and efficiencies. We do not fundamentally disagree with the principle articulated by the independent LECs.”
- Fourth Further Notice of Proposed Rulemaking, CC Docket No. 94-1, released September 27th, 1995 at ¶108. “...we found that, due to heterogeneity among LECs, a single X-factor might not be appropriate.” Also ¶109 states “A single X-factor, however, would not adequately reflect differences in the economic conditions faced by each LEC and thus could unfairly penalize or reward LECs which face conditions that differ from the industry average. For example, there are variations among the LECs’ service regions with respect to level of growth in the overall economy, the proportion of rural and urban areas for which service is provided, and the level of competition in the provision of telecommunications services.”

The Commission has never rejected the evidence presented by the mid-size companies, but rather every time concludes that the issue is too difficult to deal with or that there is not sufficient evidence on which to derive an appropriate X-factor for mid-size ILECs. The Commission’s findings include:

- Second Report and Order, CC Docket No. 87-313, released October 4, 1990 at ¶103. “Throughout this proceeding, the Commission has expressed concern that assigning one productivity factor on a mandatory basis to all the LECs, regardless of size, could prove unduly burdensome for smaller and mid-size telephone companies. In the Second Further Notice for example, the Commission acknowledged that small and mid-size companies may have fewer opportunities than large companies to achieve cost savings and efficiencies. Unfortunately, the Commission was hindered by a lack of sufficient evidence from which to determine whether a different productivity factor was appropriate, and if so, how to calculate it and to whom to apply it.”
- Second Report and Order, CC Docket No. 87-313, released October 4, 1990 at ¶104. “(t)he evidence accumulated in this proceeding casts doubt on whether all carriers below the largest eight in size can reasonably attain the productivity goal required by the price cap index.”

- Second Report and Order, CC Docket No. 87-313 at ¶114. “The record evidence does suggest that, in general, productivity for mid-size and smaller LECs might be either equal to or lower than that for the RBOCs and GTOC.... The obvious and inherent difficulties in the present record concerning the quantification of a mid-size LEC productivity factor support our decision to grant mid-size and small companies the option of voluntarily participating in price caps.”
- Second Report and Order, CC Docket No.87-313 at ¶118. “The problem remains how to group the class of small and mid-size LECs meaningfully, in a way that allows development of a particular productivity offset for them that will be reasonably achievable by all members of the group.”
- Supplemental Notice of Proposed Rulemaking, CC Docket No. 87-313, released March 12, 1990 at ¶101. Unfortunately, ..., the problem with attempting to craft a separate productivity offset for the independents has been that there is so little in the current record to provide specific guidance as to how to calculate a separate productivity factor for them.”
- First Report and Order, CC Docket No. 94-1, released April 7, 1995 at ¶199. “...in light of the demonstrated heterogeneity of the LEC industry, the range of evidence in the record concerning LEC performance under price caps, and our present inability, absent further specific information, to reach definitive decisions based upon that evidence, a wider range of X-Factors is warranted to achieve an appropriate balance of interests for each LEC during this interim period.”

B. The Commission Should Use the Evidence in the Record to Set an X-Factor for Mid-Size LECs One Percent Below the X-Factor It Sets for the Large LECs

CBT finds the Commission’s claim that it is too difficult to derive an appropriate X-factor for the mid-size LECs to be less than compelling. Even if the Commission cannot undertake a detailed analysis of mid-size LEC productivity, based on the existing record it can safely set the mid-size LEC X-factor 1% below that of the large companies with confidence that this is the minimum differential. Although the reasons for a lower X-factor may vary by company, the results of the studies presented to the Commission have consistently shown a differential of at least 1.0%. The Commission should recognize in this case, as it did in the mid-size ILEC accounting order,⁸ that the public interest can be maintained without securing the

⁸ 1998 Biennial Regulatory Review-Review of Accounting and Cost Allocation Requirements, CC Docket No 98-81, Report and Order, Implementation of the Telecommunications Act of 1996 Accounting Safeguards under the

same level of detail from mid-size LECs as from large companies. In this case, the evidence presented by the mid-size LECs, although perhaps not as detailed as the large companies present, is still adequate to make a determination that a lower X-factor is appropriate for the mid-size LECs.

The Commission has recognized differences between LECs based on size, geographic, demographic, and/or economic circumstances in many other proceedings and should do likewise here. For example, it is addressing rural carriers separately from non-rural carriers for universal service. It also chose to address access reform separately for rate of return carriers (primarily smaller carriers) versus price cap carriers (the majority of whom are large carriers). In addition, the Commission recently recognized the size and resource differential in granting some regulatory relief to the mid-size carriers.⁹ Congress has also recognized that the mid-size LECs are different from the large carriers by allowing for lesser regulation on companies with less than two percent of the nation's access lines.

It is also notable that other carriers have recently acknowledged that the smaller price cap LECs are different from the large companies. Specifically, the Coalition for Affordable Local and Long Distance Service ("CALLS") recognized that the mid-size LECs have different cost and pricing characteristics which necessitated including a higher targeted per minute switching rate in the CALLS universal service/access reform plan for price cap companies.¹⁰

Telecommunications Act of 1996, CC Docket No. 96-150, *Order on Reconsideration, Petition for Forbearance of the Independent Telephone & Telecommunications Alliance*, AAD File No. 98-43, *Fourth Memorandum Opinion and Order*, released June 30, 1999 at ¶¶14, 21.

⁹ *1998 Biennial Regulatory Review-Review of ARMIS Reporting Requirements*, CC Docket No. 98-117, *Report and Order, Petition for Forbearance of the Independent Telephone and Telecommunications Alliance*, AAD File No. 98-43, *Fifth Memorandum Opinion and Order*, released June 30, 1999, at ¶12; *1998 Biennial Regulatory Review-Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, CC Docket No. 98-137, *Report and Order, United States Telephone Association's Petition for Forbearance from Depreciation Regulation of Price Cap Local Exchange Carriers*, ASD 98-91, *Memorandum Opinion and Order*, released December 30, 1999 at ¶22.

¹⁰ The CALLS members are AT&T, Sprint, Bell Atlantic, Bell South, GTE, and SBC. See CALLS Proposal filed August XX, 1999 at pages 35-36.

The Commission should no longer cast aside the substantial evidence presented by the mid-size LECs. It may be easy for the Commission to ignore the mid-size price cap LEC X-factor by rationalizing that these mid-size LECs represent a small portion of the industry; however, regardless of their share of the market, the impact of an inappropriate X-factor on these companies is significant to the individual companies.

IV. CONCLUSION

The Court has upheld the basic 1997 TFP methodology for establishing an X-factor. There is no need for the Commission to undertake new studies or develop new methodologies to establish an X-factor. The appropriate action is for the Commission to simply correct for the problems the Court has identified in the current X-factor. The corrected 1997 TFP should be used to set the X-factor for the July 1, 1997 to June 30, 2000 period. Prospectively, the X-factor should be set using the corrected 1997 TFP model updated with recent data.

At the same time, the Commission should finally confront the substantial evidence in the record and establish a separate, lower X-factor for the smaller price cap carriers.

Respectfully submitted,

By: /s/
Christopher J. Wilson
Delia Reid Saba
Attorneys for Cincinnati Bell Telephone
Company
201 East Fourth Street
Cincinnati, Ohio 45202

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